

1954

## National City Monthly Letter on Business and Economic Conditions

New York, December, 1954

### General Business Conditions

**T**HE business uptrend has made further progress during November. Preliminary figures indicate that industrial production, measured against seasonal expectations, has risen more than in any other month since the improvement started, and has reached the highest level in a year. Rising employment, confirmation of the first upturn in manufacturers' unfilled orders, and sustained retail sales have contributed to the good showing. The most buoyant optimism to be found is in the stock market. The sharp rise in prices of course reflects many complex forces, both tangible and psychological, but among them, obviously, is a belief that the business trend is one of growth and progress.

Looking into 1955, confidence is strengthened by encouraging surveys of consumers' buying intentions and of the construction outlook. Consumers have been receiving a record-breaking volume of income after taxes, and have been spending a higher proportion of it than at any

time since the scare-buying days at the start of the Korean war. Consumer prices, according to the Bureau of Labor Statistics index, are the lowest since mid-1953. Taking prices into account, it is clear that in physical terms purchases of consumers' goods and services are at new highs. Some of the price easiness is due to retail price cutting in durable goods, which is one of the manifestations of strong competition and abundant supplies. It may have something to do with the fact that an increasing percentage of people, as shown by a University of Michigan survey in October, consider this a good time to make major purchases.

### Strong Support from Automobiles

Much of the unseasonable improvement in industrial activity traces to the introduction of the new automobile models. Passenger car assemblies are reaching the highest level since 1950. Scheduled output in December is well above 600,000 cars. This rate will not be maintained indefinitely, and in that respect business now feels a stimulus which will not be recurring. The optimism of the industry, however, is indicated by the prediction of President Curtice of General Motors that 5,800,000 passenger cars will be produced and presumably sold in 1955. This would be 300,000 or more in excess of the 1954 output, and only about the same number less than in 1953. Automobile dealers have done a good job of clearing out their stocks of '54 models; at the end of October they had only 245,000 new cars in stock, most of them '55 models.

A preview of the prospect for investment in new plant and equipment has been given by the McGraw-Hill Department of Economics, whose survey shows that industry plans to spend 5 per cent less for these purposes in 1955 than in 1954. About five-sixths of the decline in manufacturing investment is accounted for by the

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automobile companies, which will do less re-tooling for new models. Since plant and equipment outlays currently are below the average for 1954, the prospective rate for the next year or two is close to present levels. The implied decline in industrial construction is expected to be more than offset next year (as in 1953 and 1954) by expansion in other building. An overall rise of 7 per cent in construction activity, from \$37 billion in 1954 to a record \$39½ billion in 1955, is forecast in a joint study by the U.S. Departments of Commerce and Labor. This includes the starting of 1,300,000 new homes which, if realized, would be second only to the 1950 peak.

#### **Buying for Current Needs**

It is notable that the business improvement has not been caused or accompanied by any marked lengthening of commitments by industrial buyers. The emphasis is on maintaining rather than building up stocks, and purchasing agents for the most part are keeping their forward orders within sixty days' needs. Nevertheless, new orders — at long last — are coming in faster than shipments are going out. Manufacturers' unfilled orders increased this fall for the first time in nearly two years. From the peak of \$78 billion in September 1952, the backlog had been steadily whittled down to a low of \$47 billion at the end of August. This persistent decline was reversed in September and the upturn apparently continued into October and November.

Last year's slowdown in defense ordering was responsible for much of the drop in order backlogs and for a large share of the inventory liquidation. But in the four months ended October 31 nearly \$5 billion of new orders for military procurement and construction were placed. The Defense Department expects to place about \$18 billion in new contracts in the current fiscal year, nearly double the \$9.2 billion obligated in fiscal 1954. Expenditures for these purposes totaled \$21.7 billion in fiscal 1954 (out of total Defense Department outlays of \$40.5 billion), and in this fiscal year are expected to be about three billion dollars less. Thus new orders again are coming into line with expenditures. They may not be directly reflected in delivery of finished goods or government spending until late 1955 or 1956, but their current effects can be important, in inducing accumulation of necessary materials and keeping work forces together.

#### **An Example from the Steel Industry**

The steel industry is a prime example of the change in business buying which has been taking

place. In mid-August, steel mills were operating at 61.8 per cent of capacity; by the end of November the rate was 80.5 per cent, nearly one-third higher. Cold-rolled sheets — much in demand by automobile and appliance manufacturers — could be obtained in three weeks or less early in the fall; now mills have resorted to informal rationing and delivery dates stretch well into the first quarter of 1955.

Benjamin Fairless, chairman of United States Steel Corporation, noted in mid-November that order backlogs of his company were on the upgrade again and steel production was "not too far below the level which might be regarded as normal in an average peacetime year". Furthermore, he stated:

Our market analysts conclude that the actual consumption of steel could decline somewhat in 1955; but that the production and sale of steel will increase. And the explanation of this seeming paradox, of course, is really very simple. . . .

For a great many months now, America has been consuming a good deal more steel than it has been producing. Our surveys show, for example, that in the five months from April through August of the present year, about 15 per cent of all the steel that was used in this country came out of inventories. Today, however, it appears that this process of inventory cutting has gone just about as far as it can go; and in some cases, I am inclined to believe that it has been carried beyond the point of prudence. . . .

Even if [steel inventories] simply remain at their present low level, I would estimate, conservatively, that our industry will have to increase its output, next year, by some 5 to 10 million ingot tons — just to keep pace with the anticipated rate of steel consumption.

This statement describes the situation in many of the markets for industrial materials. Almost from the time the recession started, part of the day-to-day consumption has been supplied out of inventory. Now the policy has shifted, of necessity, from one of liquidating stocks and paring commitments to buying more in line with current needs.

The statement also strikes another note, in the possibility that "the actual consumption of steel could decline somewhat in 1955". To many this will seem surprising, in view of the optimistic expectations of the automobile and construction industries. However, it serves the useful purpose of reminding business men that the pace of recovery is likely to be moderate and orderly, just as the decline last year was moderate and orderly. The welcome signs of improvement give no reason for abandoning the careful policies which have served business so well and contributed so much to general stability during the postwar period.

## Federal Regulation vs. Competitive Enterprise in Natural Gas Production

Among the major questions expected to come before the new Congress in January is one vitally affecting the development of a most important natural resource — natural gas. Specifically, the question the Congress will be called upon to decide is whether federal regulation of natural gas — long applicable to the pipeline companies which transport gas for resale in interstate commerce — should include also the independent producer who sells his gas to interstate pipeline companies; or whether the public interest is best served if producers retain their traditional freedom to produce, bargain, and sell under the competitive conditions that have applied to the production of all fuels.

This issue was brought to a head by the decision of the Supreme Court last June in the case of *Phillips Petroleum Company vs. State of Wisconsin, et al.* The Court construed the regulatory powers and duties of the Federal Power Commission under the Natural Gas Act of 1938 as applying to independent producers who sell to interstate pipelines as well as to the pipeline companies themselves. The decision came like a bombshell to the producing industry since it cut across long-established practices in the marketing of gas and also because of its far-reaching implications for the future of the industry.

In the sixteen years since the passage of the Natural Gas Act, the independent producers have operated on the assumption that they were exempt from federal regulation under the provisions of that Act which stated that it "shall not apply to the production and gathering of natural gas." Producers have freely made contracts for sale to pipeline companies doing interstate business under the specific assurance, stated in studied opinions of the Federal Power Commission itself, that such sales were not subject to federal regulation. This condition has contributed greatly to the rapid growth of interstate pipelines.

In 1950 the Congress passed the Kerr Bill for the express purpose, to quote Senator Lyndon B. Johnson of Texas, the slated Democratic majority leader of the Senate in the new Congress, "of reconfirming the original Congressional intent of exempting such sales from FPC control". The bill, however, was vetoed by President Truman.

Despite these precedents, the Supreme Court has now ruled that gas sales to interstate pipe-

lines by independent producers are subject to federal regulation; unless and until the Congress amends the Natural Gas Act this remains the law of the land. Because of the prospect of early Congressional consideration of these matters and their importance to the national welfare, a broad public understanding of the issues is desirable.

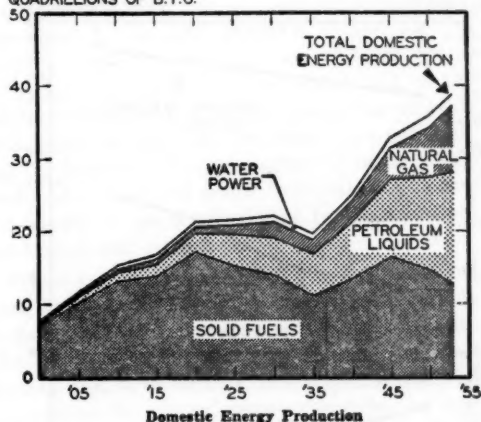
### Growth of Natural Gas

Why is this problem of gas regulation of national importance?

Foremost among the reasons is the matter of developing and maintaining adequate sources of energy for the future. The nation's security as well as its economic well-being is built around energy-powered industry and the fuel-consuming mechanisms of modern warfare. In meeting these constantly growing needs, natural gas has played an increasingly important part.

As shown by the accompanying chart, growth in natural gas usage in our industries and homes has been especially rapid since the end of World War II. It approximately doubled during that period to the point where this fuel now furnishes nearly a fourth of the nation's total energy. Today the proved reserves of natural gas represent a greater amount of aggregate energy than is represented by all of the proved reserves of liquid petroleum.

QUADRILLIONS OF B.T.U.



This great increase in use of natural gas has been spread widely throughout the country. There are now only four states — three in the Pacific Northwest and Vermont — which do not have natural gas. The number of customers using it has more than doubled since 1945. Approximately 21 million customers are now supplied with it and an additional 4 million are using it mixed with manufactured gas. Still the demand appears insatiable. In Chicago alone over 135,000 names are on the waiting list for

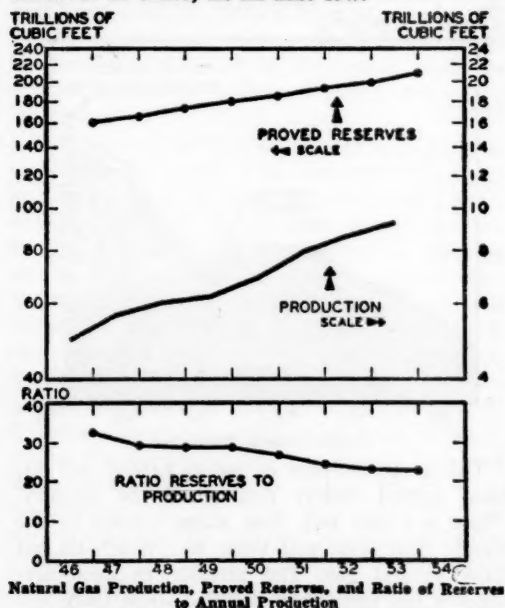
natural gas residential heating. A generally similar situation prevails in other important consuming areas.

Manifestly, any development that affects the supply and availability of so important a fuel is of concern to everyone.

#### Question of Reserves

In considering the problem of future supplies of natural gas, one of the prime factors is the status of known and proved reserves. Despite the rapid increase in production in recent years, estimated proved recoverable reserves have been increased by discoveries of new fields, extensions of known fields, and upward revisions of prior estimates. At the end of 1953 the proved reserves of natural gas in the nation were 211 trillion cubic feet, up 32 per cent since 1946.

Gratifying as this increase may appear, it still represents a rate of growth less rapid than that of production. In 1953 net production amounting to 9.2 trillion cubic feet was 87 per cent over 1946. As a result of consumption increasing at a faster rate than reserves, the ratio of proved reserves to annual production has, as the next chart shows, gone steadily downward. Whereas at the end of 1946 reserves were 33 times annual production, by the end of '53 they had declined to 23 times, an all-time low.



It should be noted that these ratios of gas supply are based on current rates of production and do not allow for expanding future demand. Moreover, substantial concentrations of proved reserves sufficient in size to warrant construction

of large pipeline projects are already dedicated to the market under existing contracts. It will require the discovery of new supplies to meet the constantly swelling demands of new and old customers.

These facts as to the status of proved reserves are not presented with any intent to be alarmist. Allowance may be made for an annual discovery rate which so far has kept reserves rising with production, albeit by a steadily shrinking margin. What the facts point up is the ever-growing need for discovery of new supplies to replace production. They serve as a warning against complacency in consuming areas. Maintenance of the discovery rate of the past is not preordained, but depends upon preserving the incentives which have made enterprisers willing to incur the risks and expense involved in the search for and development of new gas supplies.

That the effects of the Supreme Court decision in the Phillips case may, unless nullified by legislative action, prove to be "profound" was recognized by Justice Douglas in his dissenting opinion.\* As he stated in language that could hardly be more forceful:

The price at which the independent producer can sell his gas determines the price he is able or willing to pay for it (if he buys it from other wells). The sales price determines his profits. And his profits and the profits of all the other gatherers, whose gas moves into the interstate pipelines, have profound effects on the rate of production, the methods of production, the old wells that are continued in production, the new ones explored, etc. Regulating the price at which the independent producer can sell his gas regulates his business in the most vital way any business can be regulated. That regulation largely nullifies the exemption granted by Congress.

#### Problems of Federal Regulation

It should be pointed out that, quite apart from any question of regulatory philosophy to which we revert later on, federal regulation of natural gas producers presents serious practical problems.

It is one thing for the Government to regulate the rates of some forty or fifty interstate pipeline companies — mostly established major enterprises — whose costs can be determined with reasonable accuracy. It is quite another thing to regulate the rates of some thousands of independent gas producers, large and small, whose methods of operation cover the widest possible variation and whose costs cannot be determined with any degree of exactitude.

Even regulation of the pipeline companies has had its difficulties, as attested by the record of

\*Justices Clark and Burton also joined in a dissenting opinion to the 5-to-3 decision in this case.



some cases dragging on for years before settlement. How much more formidable the task of regulating the multitude of independent producing units, each with its own set of complexities! As an example of some of the possible headaches involved, we cite the following from an address by John W. Boatwright, Assistant General Manager of the Supply and Transportation Department, Standard Oil Company (Indiana), before the American Petroleum Institute last month:

How can the Federal Power Commission determine the cost of the product offered from a well? Well X here in field A may have been brought in by a producer who previously put down 13 dry holes in a futile search for oil. Well Y in the same field may have been brought in by a company that has made three strikes in a row — but that has to set aside a reserve to finance the probable dozen or so dry holes it will drill in the months ahead. Well Z off a little way in the same field may be producing oil and gas together in a fluctuating ratio. Also consider the radically different prices paid to lease and royalty owners. How do you strike a fair balance on costs for the same gas produced from the same field let alone the cost in other fields in other areas? Frankly, this problem defies solution.

In view of the overpowering complexities inherent in any attempt to regulate producers by the "rate base" method, it is significant that in at least one case the Federal Power Commission has allowed a natural gas pipeline company the so-called "fair field price" on its owned gas put into its pipeline system. The Chairman of the Federal Power Commission, Jerome K. Kuykendall, stated that the Phillips decision does not confine the Commission to the use of the "rate base" method of valuing natural gas. However, the application of the "fair field price" method to all producers would have its own particular crop of difficulties.

Not the least of the problems involved in federal regulation of gas producers are the potentialities of conflict between the federal and state regulatory authorities. The latter are concerned primarily with the conservation of natural resources and prevention of physical waste. It is inevitable that the overlapping authorities will not see eye to eye on many of the problems involved.

Because of the many inseparable relationships of oil and gas production, oil men fear that the attempt to resolve these regulatory difficulties may result in moves towards putting the entire oil industry under federal rule.

It should be pointed out that the Federal Power Commission is well aware of these difficulties. It has not sought these additional powers; on the contrary, it has consistently ruled

that the Natural Gas Act definitely exempted independent gas producers from its jurisdiction. Now, however, that these new responsibilities have been thrust upon it, the Commission has given evidence of its recognition of the importance of proceeding with caution and discretion. It has invited suggestions as to principles and methods to be applied by it in its regulation of the rates to be charged by independent gas producers. The following remarks by Mr. Kuykendall before the American Petroleum Institute last month are significant:

The Commission realizes that the business of exploring for and developing natural gas reserves entails many risks, and that the financial rewards must be commensurate with those risks, if exploration, drilling, and production are to continue. We intend to recognize this indisputable fact in our rate making, no matter what methods may be employed in testing the reasonableness of producers' rates.

The fact remains that even with the best of intentions on the part of the Commission the situation, as it stands, is disturbing to all concerned in the gas industry. This is true not only because of the inherent difficulties of "testing the reasonableness of producers' rates," but also because of uncertainty as to the rate-making philosophy of future commissions.

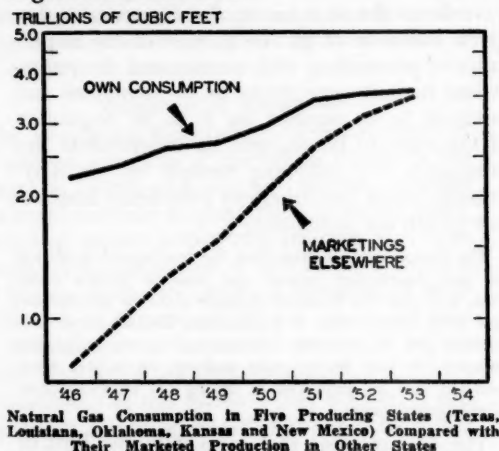
#### **Interstate vs. Intrastate Competition for Gas**

One of the most natural and immediate consequences of the new situation is to force gas producers to take another look at their operations and prospects from the standpoint of the relative advantages of selling gas to the pipeline companies for interstate transmission, or of seeking to develop a larger market at home. This could be a factor of major importance affecting the supply of gas available for future interstate movement and consumption.

While gas is produced over a widely scattered area, its major production is concentrated largely in the southwestern portion of the United States. The five states of Texas, Louisiana, Oklahoma, Kansas, and New Mexico have approximately 88 per cent of the proved reserves and 84 per cent of the nation's current production. Texas alone has more than half of the total reserves and accounts for more than half of the total national production.

On the other hand, with the development of long distance transmission lines, the consumption of gas has, as we have seen, spread widely over the country. Today some 70 per cent of the gas consumed outside the above five southwestern states comes from those states. The next chart depicts the phenomenal increase in the

movement of gas from this five-state producing area, together with the increase in consumption of gas within that area.



The dependence of the rest of the country upon southwestern gas will, in the normal course, continue to increase as new pipeline capacity is built to meet the constantly growing demand. Projected plans for future construction, according to Earl H. Eacker, former president of the American Gas Association, involve a record \$3.5 billion construction program over the next four years, with 90 per cent of the expenditures going into natural gas systems.

All this highlights the importance of maintaining and increasing the availability of gas supplies by encouraging discovery and development by independent producers. In fact, this encouragement should be extended to the producing operations of the interstate pipelines as well.

This is all the more necessary since — with steadily increasing consumption within the present major producing area — it is becoming more and more difficult to find sufficient quantities of uncommitted reserves to provide the gas supply for new or expanding transmission lines. Because cost of transportation and distribution represents many times the field price of the gas itself, industrial consumers are becoming more impressed by the desirability of locating plants in the producing areas. Since intrastate markets in these areas are becoming more attractive, gas will not be diverted to distant markets without a compensating price incentive. It is evident that when federal regulation enters the picture millions of consumers elsewhere have reason to be concerned as to their chances of sharing in the gas which may be available overall.

### The Factor of Prices

As to prices, there are many indications that normal economic stabilizing influences are taking effect. One must not lose sight of the basic fact that gas is a premium fuel from the standpoint of cleanliness and convenience. Many consumers are willing to pay a premium for it. However, substantial quantities of the gas transported through the pipelines are used by large industrial consumers. These sales are usually made on an interruptible basis which provides for curtailment when firm demands, principally from residential and commercial customers, reach a point on cold winter days which takes the pipelines' full delivery capacity. The pipelines are willing to sell off-peak or interruptible gas at a lower price in order to improve their load factor, or ability to buy and sell gas at an even rate throughout the year. This is of vital importance in negotiating supply contracts on a satisfactory basis and establishing more favorable rates for firm demand consumers.

Large industrial users such as power plants, cement mills and the like where fuel is an important item of costs, are equipped to burn either gas, oil or coal and they switch from one fuel to another depending upon relative prices. It is noteworthy that prices of the three principal industrial fuels are highly competitive in many sections of the country and are becoming increasingly so as the cost of gas rises.

This all indicates that, as in the past, reliance on competition will establish fair prices for natural gas without exposing the industry to the hazards of further federal regulation.

### Basic Principles Involved

Finally, there is the basic question of regulatory philosophy, to which we referred earlier.

Under our system of democracy, government regulation is intended to apply only to those industries where a monopoly, or at least a semi-monopoly, exists.

The gas producing industry, however, is anything but a monopoly. Its thousands of separate units — individuals and corporations — engaged in the search for and development of oil and gas resources, are in the stiffest sort of competition with each other. Their position is basically different from that of the utilities marketing gas at retail and the pipeline companies transmitting it to consuming areas.

Gas producers are not only in competition with each other, but their product competes with oil and coal the prices of which are not regulated. Actually, there is no more ground for

federal regulation of natural gas prices in the field than for federal regulation of prices of oil and coal. Once the step is taken with respect to natural gas, it can be argued just as logically that it ought to be taken with respect to other fuels — and, for that matter, with respect to any other competitively produced commodity. This is the road to socialism.

Thus, when all is said and done, the issue comes down to the question of the kind of economic system we believe in — one that is regulated by the Government, or one that gives maximum scope to private initiative, enterprise, and competition. In the gas industry, the producer's freedom to discover, develop, produce, and to sell his gas in a competitive market has been basic to the industry's growth and ability to meet increasing demands. To change the rules now might seriously inhibit this progress, to the detriment of consumers and of the maintenance of a sound energy policy for the nation at large.

### **Progress Unlimited**

Much as the decade of the Thirties was a decade of economic pessimism, the decade of the Fifties has emerged as a decade of economic optimism. Instead of stagnation and maturity, people talk of growth and development. Economists vie with one another in projecting the growth we may expect over the next five, ten or twenty years. Business men plan ahead for bigger markets and develop new products to capture the fancy of tomorrow's consumer. In so doing they are encouraged by a friendliness of government toward enterprise that was not present in the Thirties, the unpredicted resurgence of population growth, and a generous flow of savings for investment.

The release of atomic energy, achieved at immense capital cost during World War II, is only the most dramatic of the developments that have dispelled the idea that the industrial revolution was ended and revived the traditional American dream of progress unlimited.

The most extravagant estimates of what the future may hold have been prepared by a newly-formed "Conference on Economic Progress", under the leadership of Leon H. Keyserling who was chairman of the President's Council of Economic Advisers in the Truman Administration. The CEP put out a report in July, entitled "Toward Full Employment and Full Production", arguing that, provided the policies they advocate are pursued, the economy can be kept going full blast all the time and reaching new

peaks of production and employment every single year. In the past, under Republican and Democrat regimes alike, we have had lean years sprinkled in among the record-breakers. In the forty-five years since 1909, the national production has reached new peaks in nine out of eleven war years, but in only thirteen out of thirty-four nonwar years.

### **The Eighty-Year Record**

The progress of a nation depends on the efforts of people, individually and competitively, to get ahead, to improve the land, to raise the crops, to find better tools and sources of heat and power, to speed transportation and communication, and to produce and market the things that are most wanted. In the 34th Annual Report of the National Bureau of Economic Research issued last May, Solomon Fabricant, Director of Research, reviewed the substantial growth of income in relation to population the United States has enjoyed over the eighty-year period covered by the Bureau's studies:

The average per capita volume of goods consumed or added to the tangible capital stock of the nation has been multiplied over fourfold. Were we to include in national income the goods and services devoted to the nation's defense, the rise would be greater still.

Income per capita, he observes, has moved forward "with considerable irregularity" at an average rate of 1.9 per cent per annum. He goes on to say:

The average family in the United States had an income of somewhat over \$5,000 in 1953. If we progress at as high and consistent a rate in the next eighty years as in the last, our grandchildren or great-grandchildren will have average family incomes of about \$25,000 of 1953 purchasing power — a level now attained only by the top 1 per cent or so of the nation's families.

The "if", to be sure, is important. Dr. Fabricant appropriately examines the question: How did this remarkable growth in income per person come about?

Apart from chance, a country's output always depends on what its people put into production — on the hours and the energy, the tangible machines and the intangible knowledge and skill, the enterprise and the prudence, the habits of independence and of cooperation, which they bring to their work.

On work done per capita, "labor input", he cited opposing trends — shortening hours of work and an increasing proportion of the population in the work force. Thus, "any change in labor input per person has been slight." On the other hand, "capital input per person" has increased greatly and also the efficiency of production:

Those who stress the role of savings in our economic growth are right to do so, for they point to the dominant



factor in the increase of our material resources. The nation's tangible wealth (net of depreciation, depletion, and obsolescence reserves and adjusted for price changes) has been multiplied several times more rapidly over the past eight decades than our population. . . .

It is a challenging fact that most of the rise in tangible capital per person came in the period before the Great Depression. Between the 1870's and the 1920's, capital per person rose at a fairly consistent average annual rate of about 2.5 per cent. During the depression, however, and after a brief interruption, again during World War II, it fell while population continued to rise. Since the war capital per person has grown rapidly, but this recent acceleration has not yet done much more than offset the decline during the preceding fifteen years: on net balance, per capita real tangible reproducible capital today is only moderately above the predepression high.

#### **\$500 Billion Within Ten Years**

Dr. Fabricant did not attempt to calculate what value the national production might reach eighty years hence. But projections of gross national product for five, ten or even twenty years hence have become a commonplace. An Administration target of \$500 billion a year within a decade was suggested by President Eisenhower in an address on Oct. 25:

Drawing on the richly varied abilities of our entire citizenry, we can foresee that in less than a decade the national output will increase from today's \$356,000,000,000 to \$500,000,000,000. This would equal an average increase of more than \$3,000 for every American family of today. And these can be real dollars — dollars of stable buying power, not simply more dollars of cheapened value.

The chart at the bottom of the next page gives the record of the gross national product since 1909, the period covered in the consecutive annual estimates of the United States Department of Commerce and the Congressional Joint Economic Committee staff. The actual figures are given in the broken line; the figures in terms of the 1953 dollar are given in the solid line; the price factor, which explains the difference, is shown by the dotted line. The ruling is semi-logarithmic to show proportional changes.

Projected into the future are growth estimates for 1955-65 given by the Staff of the Congressional Joint Economic Committee in a report published a month ago, and for 1960-70 by the McGraw-Hill Publishing Company in a report put out last spring. These are among the projections that have received more or less widespread publicity and are more or less typical of the sorts of appraisals on which business men today are basing their longer-range plans.

The general method is to take first a rate of increase in output per man-hour, around 2 per cent, resulting from capital investment and rising efficiency of production. Then the slope of the

projection is steepened, to perhaps 3½ per cent, to allow for growth in the population and working force of around 1½ per cent a year. Finally, the rate of advance is bent down, nearer 3 per cent, to compensate for a tendency of working hours to shrink. These projections are not intended to be forecasts of business in any particular year. Their value is in forecasting a trend and setting benchmarks for planning.

#### **"Progress" by Inflation**

Also projected ahead on the chart are two estimates of the "Conference on Economic Progress" above-mentioned. One, based on a 4.2 per cent annual rate of growth, passes the \$500 billion mark during 1960; the other, based on a 6.5 per cent rate, approaches \$600 billion in 1960. The CEP report gets some of its spectacular rise by failing to make any specific allowance for further shortening in working hours. Even so, most observers would doubt that such ambitious results could be achieved without a sizable increment from price inflation.

By the performance of the actual figures all of the projections look conservative, most particularly against the record of 1933-53. From not much more than \$1 billion a week in 1933 the national product in 1953 reached \$1 billion a day. If that rate of growth, averaging 9.8 per cent per annum, is projected ahead we could cross the trillion dollar mark only ten years hence, in 1964. This would be a dubious achievement. The dollar shrank in purchasing power by 4 per cent per annum over the twenty years and to that extent the rise in the gross national product since 1933 is merely a distortion caused by a shortening yardstick. Furthermore, much of the rise during the war was accounted for by the absorption of resources unemployed during the depression.

There are of course no bounds at all on the value the national product might achieve if the price level inflates out of hand. When that happens the rise in the dollar value of the national product becomes a measure, not of economic progress, but of industrial, political and social disintegration.

The CEP report is impressed by our "onrushing productive power", founded on technology and productivity rising "faster and faster". This, it holds, is a "chronic menace to our well-being". While a deep depression may be unlikely, "direct expansion of consumption is of utmost urgency in the current economic situation." How is this to be accomplished? Among other things by a \$3 billion a year increase in federal gov-



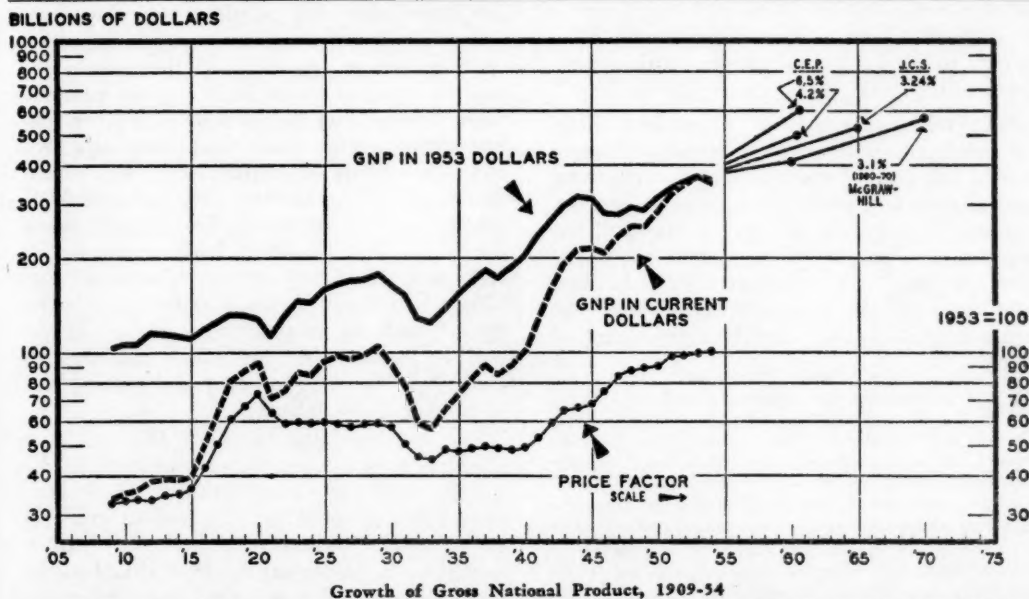
ernment spending, a \$4½ billion a year reduction in personal income taxes "with as much of the reduction as feasible as far down in the income structure as feasible", continuation of the present liberal credit and monetary policy, gradual enlargement of the public debt, more aid to farmers, increased wages and unemployment pay, and two million units a year of home construction.

These things done, we can cut unemployment to an "irreducible minimum" of 1,500,000 and look forward to annual growth in national product of 4.2 per cent as a minimum and 6 to 7 per cent as a maximum. This latter rate is obtained by projecting ahead the rapid gain in productivity from the second quarter of 1950 to the second quarter of 1953. This, it may be noted, was the period of the Korean war when technological progress was aided by emergency restraints on consumer goods production and consumption, special tax encouragements to industrial investment, and curtailed housing construction. Consuming more of current production, as the CEP proposes, curtails the resources for labor-saving, cost-cutting investments.

The CEP report, omitting any statement of price stability as a desirable end, denies that price inflation at any time since the war has

been the result of full employment. The inflationary price spurts of 1946-48 and 1950 are attributed among other things to "war-created factors", "the premature demolition of wartime controls", and "previous neglect of certain important aspects of a comprehensive full employment policy." It may be logical to presume that the business recession of 1949-50, which built unemployment up to higher levels than have been experienced in 1954, would be attributed by the authors of the report to the failure of the Government to pursue adequately inflationary fiscal and credit policies at that time. The report criticizes the Administration's "hard money" policy, and attacks the budget-balancing effort as the prime cause of the 1954 business recession. The record from early 1951 to the middle of 1953 is cited as a model of sustained full employment prosperity, one in which "we witnessed the highest levels of employment and production we have known in this country, without sizable inflation."

As a benchmark of what the authors consider to be an absence of sizable inflation, the index of consumer prices rose at a rate of 2.1 per cent a year from February 1951 to December 1952. This slowing of the rise, it is relevant to note, was aided by the imposition of government price



Sources: Gross national product—U. S. Department of Commerce and Staff of the Congressional Joint Economic Committee; price factor computed. Projections (all in 1953 dollars; percentages refer to projected annual rates of growth)—Conference on Economic Progress (CEP) report, "Toward Full Employment and Full Production"; Congressional Joint Economic Committee Staff (JCS) report, "Potential Economic Growth of the United States during the Next Decade"; McGraw-Hill report, "The American Economy, Prospects for Growth."

controls in January 1951 and by the unpegging of the government bond market in March 1951. During the first half of 1953 price controls were discarded and the burden of protecting the dollar from further shrinkage was borne by the much-castigated "hard money" policy and the budget-balancing effort.

### **Three Big Questions**

All of this discussion raises three big questions:

1. Does "full employment" erode the value of the dollar?
2. Does "full employment" speed economic progress?
3. How do we build up to full-blown depressions?

The answer to the first of these questions depends on what is meant by "full employment" and on what we do to achieve it. The official statistics show no peacetime year since 1929 in which unemployment has averaged less than 2,000,000. Every year since then that unemployment has averaged less than 3,000,000 has been a year of rising prices. Thus, when the CEP urges that we should set out to bring unemployment down to a level of 1,500,000, and proposes inflationary policies to accomplish the objective, we have no escape from the conclusion that they are prepared to accept rising prices—or prepared to plaster the economy with price controls to keep the consequences of their policies from registering in the price indexes.

Some other advocates of government fiscal and credit policies to keep the economy running under a full head of steam all the time are more frank in their appraisals of the inflationary risks. Professor Sumner H. Slichter of Harvard, for example, has projected an indefinitely rising price trend under the influence of "full employment" policies. In various speeches over the past few years he has expressed this point of view:

It is important for the community to face squarely the fact that there is a conflict between maximizing employment and maintaining stable prices. We can keep prices stable in the long run, but only at the cost of some preventable unemployment. . . . My view is that it is better to accept a slow rise in the price level in order to get the maximum possible employment and output than to maintain stable prices by measures that produce preventable unemployment and cause the standard of living of the community to be less than it might be.

Professor Slichter does not say how far we should go, with inflationary measures, to minimize unemployment, though this year he has criticized the Administration for cutting govern-

ment expenditures so much and for not cutting taxes more. The unemployment peak was 3,725,000 in March; the first ten months' average was 3,300,000; the price level has been stable.

Senator Paul H. Douglas of Illinois, an expert on labor statistics and welfare as well as a defender of sound money, published a book in February 1952, "Economy in the National Government", in which he evaluated the inflationary risks in setting too low a target on the unemployment rate. "To use deficit financing in order to drive unemployment down below 6 per cent", he said, is "very dangerous": "It will tend to do far more harm through inflation than the good it will do by absorbing some of those who are unemployed from seasonal and transitional causes." Six per cent of the current labor force of 65 million would be equivalent to nearly 4 million persons. He makes this allowance, among other things, for the great varieties and seasonal changes in our climate, our greater competitive expenditures which lead to cycles of style and seasonal employment, and the very great mobility of our population.

### **"Full Employment" and Economic Progress**

It is obvious that the more people that work and the longer they work the more is produced to be consumed. The CEP report seems to go a step further assuming, without any effort at proof, that the more people are employed, the faster the pace of economic growth. This idea is open to serious question. If the demand for existing types of goods is strong, the manufacturer does not feel the pressure of need to push forward with product and method improvements which are costly, time-consuming, and disruptive of current production. The automobile industry provides examples. The biggest investments in plant facilities, labor-saving devices and model improvements were deferred until 1954, when the shift from a sellers' to a buyers' market made the manufacturer feel the full competitive pressure and confronted him with the choice of improving product and cutting costs or sinking out of business.

The economy that the CEP idealizes is an overtime economy, an economy of chronic labor shortage and high labor turnover, an economy in which employers are inclined to grant excessive wage increases because they can be passed on in higher prices. It is a flabby economy of easy come, easy go, without urgent need to tighten up efficiencies. It is an economy in which blueprints of constructive new projects are put aside because supplies of labor and materials cannot be assured.

The use of unemployment as a bad word carries over from the harsh days of the depression when for ten years unemployment ranged between 7,700,000 and 12,800,000. It is time we stopped talking about *full* employment, which was rejected in favor of "maximum employment" as an objective of national policy when the Employment Act of 1946 was framed. We can never have full employment because we are unwilling to deny employees freedom to leave jobs and look for others and employers freedom to adjust work forces to fluctuating markets for their wares. Even the CEP, Mr. Keyserling and Mr. Reuther approve a figure of 1,500,000 which they indicate "may be close to the irreducible minimum of 'frictional' unemployment in a free and flexible peacetime economy." The question is whether this would leave a mobile work force sufficient to accommodate a maximum rate of economic progress and change.

#### ***The Road to Depression***

Projections of the national product years ahead expressly or implicitly exclude the possibility of war or major depression. The CEP report is not oblivious to the risks of the latter but seems to feel in effect that every downturn in business contains the seeds of full-blown depression and must be stopped in its tracks. Anything less than maximum production at any particular point of time is calculated as a "national economic deficit": "Only a steadily growing economy can avoid the costs of national economic deficits." The loss (in the shrunken 1953 dollars) of the Great Depression is calculated at \$635 billion. In a speech on September 26, Mr. Keyserling reportedly stated that "the penny squeezing and stupid economic policies" of the Republican Administration had cost the nation a loss of \$30 billion in annual output.

There are good reasons to hope that we may escape long and deep depressions of the model of 1930-40. If we do, it will be because we have remembered the lessons of that tragic period. The prelude to the Great Depression was five years, 1925-29, in which the real national product — along the lines of the CEP recommendation — successively reached new record peaks. This experience, unparalleled in our peacetime history, convinced people that the nation had learned how to master the business cycle. The business recessions of the postwar period, of

1946, 1949, and 1954, have been brief and mild as these things go, and contrast radically with the predictions of disastrous unemployment after the war. Nevertheless, Mr. Keyserling and his associates are not satisfied with this achievement. They want boom all the time. They want to throw away the restraint of knowledge that business fluctuation is as normal to our economy as breathing is to the individual.

We have shot for the moon before and suffered the consequences of uncontrolled over-optimism and excessive greed. Indulging grand hopes of perennial boom, we have placed an unbearably heavy mortgage on the future and then seen that mortgage foreclosed. This happened in the "new era" of the Twenties; it happened in the "new era" at the dawn of the Twentieth Century. Every generation has had to learn this costly lesson from first-hand experience. The present danger to our economic progress is not from modest short-term swings in business but from longer cycles; it is from building aspirations too high and staking our solvency on the fulfillment of those aspirations.

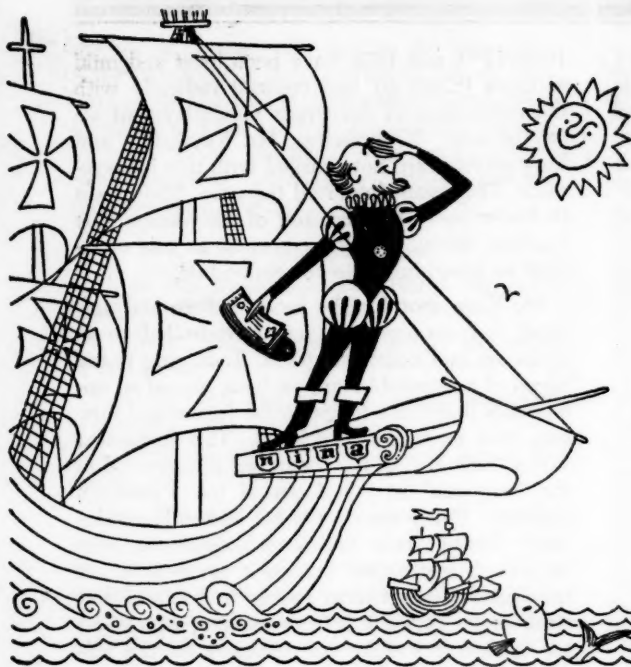
#### ***Demands of Progress***

In a world of wars, crimes, famines, and subjections of people to unprincipled dictatorships, temporary periods of business slump are not the worst peril to which men are exposed. A temporary period of slump gives a business man reason to consider what is wrong with his price, product, and manufacturing process; it gives the employee laid off an opportunity to reconsider his place and type of occupation, accommodating the shift of manpower and machinery toward products that people collectively want most to have. There can be little progress in an economy where employers and employees lack the will and necessity to accommodate themselves to what the consumer wants.

The issue is not whether we can have economic progress. The issue is whether, by the means we choose to meet maladjustments that arise, we promote or hinder the adjustments of the productive and distributive mechanism to the wants of the people, and foster or destroy the balancing of competitive forces that can give a soundly expanding economy, based on a reliable currency and a sustained flow of new savings for investment.

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